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GENERAL COUNSEL

January 6, 2005

Mr. Charles L.A. Terreni
Chief Clerk/Administrator
South Carolina Public Service Commission
101 Executive Center Dr., Suite 100
Columbia, SC 29210

Re: Application of Bush River Utilities, Inc. for an approval of New Schedule of Rates and Charges for Sewage Service provided Residential and Commercial customers in all areas served.
PSC Docket No.: 2004-259-S

Dear Charles:

Enclosed for filing please find twenty-six copies of direct testimony for the following Office of Regulatory Staff witnesses: Dawn Hipp, Willie Morgan, and Roy Barnette. Please date stamp the extra copy enclosed and return it to me via person delivery same.

Please let me know if you have any questions.

Sincerely,

Benjamin P. Mustian

BM/cc
Enclosures

cc: Charles Cook, Esquire

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2004-259-S

IN RE: Application of BUSH RIVER)
 UTILITIES, INC. for Approval of)
 New Schedule of Rates and Charges)
 For Sewage Service Provided to)
 Residential, Commercial and)
 Wholesale Customers in all areas)
 Served.)

CERTIFICATE OF SERVICE

This is to certify that I, Cindy Clary, an employee with the Office of Regulatory Staff, have this date served one (1) copy of the Direct Testimony and Exhibits of: Dawn M. Hipp, Willie J. Morgan, and Roy Barnette in the above-referenced matter to the person(s) named below by causing said copy to be deposited in the United States Postal Service, first class postage prepaid and affixed thereto, and addressed as shown below:

Charles Cook, Esquire
Elliott & Elliott, P.A.
721 Olive Street
Columbia, South Carolina 29205


Cindy Clary

January 6, 2005
Columbia, South Carolina

2005 JAN -6 PM 4:44
SO PUBLIC SERVICE COMMISSION
RECORDED

THE OFFICE OF REGULATORY STAFF
DIRECT TESTIMONY AND EXHIBITS
OF
Roy Barnette



RETURN DATE: OK D.W.
SERVICE: OK D.W.

DOCKET NO. 2004-259-S
BUSH RIVER UTILITIES, INC.
APPLICATION FOR RATE INCREASE
TEST YEAR ENDED DECEMBER 31, 2003

TESTIMONY OF ROY H. BARNETTE**FOR****THE OFFICE OF REGULATORY STAFF****DOCKET NO. 2004-259-S****IN RE: BUSH RIVER UTILITIES, INC.**

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Roy H. Barnette. My business address is 1441 Main Street, Suite 300, Columbia, South Carolina, 29201. I am employed by the Office of Regulatory Staff as an Auditor.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND YOUR BUSINESS EXPERIENCE.

A. Following a six-year enlistment in the United States Marine Corps, I received a B. S. Degree in Business Administration, with a major in Accounting, from the University of South Carolina in 1968. From 1968 to 1971, I was employed with S. D. Leidesdorf and Company, a national CPA firm in Charlotte, North Carolina. In 1972, I entered the private business sector where I worked for Bagnal Builders Supply Company, Inc., in Columbia, South Carolina, serving as Senior Vice President and Chief Financial Officer from 1972 until September, 1999. From September, 1999

1 until December, 2004, I was a member of the Audit staff of the South Carolina Public
2 Service Commission where I participated in cases involving gas, water and
3 wastewater companies. In January, 2005, I began my employment with the Office of
4 Regulatory Staff (ORS).

5 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY INVOLVING BUSH**
6 **RIVER UTILITIES, INC.?**

7 A. The purpose of my testimony is to set forth my findings and recommendations
8 resulting from the ORS Staff's review of the application of Bush River Utilities, Inc.
9 (BRUI), in this docket.

10 **Q. PLEASE IDENTIFY THE EXHIBITS ATTACHED TO YOUR PREFILED**
11 **TESTIMONY.**

12 A. I have attached the ORS Audit Report related to BRUI's Application for a Rate
13 Increase, Docket No. 2004-259-S. The contents of the Audit Report were either
14 prepared by me or were prepared under my direction and supervision in compliance
15 with recognized accounting and regulatory procedures for Water and Wastewater
16 utility rate cases.

17 **Q. PLEASE EXPLAIN THE CONTENTS OF THE AUDIT REPORT.**

18 A. As outlined in the Index of the Audit Report, pages 1-4 contain the analysis of BRUI
19 and its application. The remaining pages consist of exhibits which were prepared to
20 show various aspects of BRUI's operations and financial position. The majority of
21 my testimony will refer to Audit Exhibit A - Operating Experience and Operating
22 Margin as shown on page 5 of the Audit Report.

Q. PLEASE DESCRIBE THE FORMAT OF AUDIT EXHIBIT A.

A. Column (1) shows per book balances of BRUI as of December 31, 2003. I verified the per book balances to the books and records of BRUI.

Column (2) shows my accounting and pro forma adjustments designed to normalize BRUI's per book operations.

Column (3) shows my computation of BRUI's normalized test year prior to implementing the proposed increase.

Column (4) shows ORS's adjustments for the proposed rate increase as furnished by the Water/Wastewater Department and the adjustments associated with the additional revenues. As explained by ORS witness Dawn Hipp, the proposed rate increase used by ORS is based on BRUI's proposed rate increase associated with Phase I only.

Column (5) shows our computation of the normalized test year after accounting and pro forma adjustments, including the proposed rate increase and associated adjustments.

Q. PLEASE ELABORATE ON THE CALCULATIONS IN AUDIT EXHIBIT A - OPERATING EXPERIENCE AND OPERATING MARGIN.

A. Column (1) shows the per book operating experience of BRUI. We computed Total Income (Loss) for Return of \$2,201 based on Total Operating Revenues of \$266,084 less Total Operating Expenses of \$263,883. BRUI did not experience any customer growth during the test year. Total Income (Loss) for Return of \$2,201 and Total Operating Revenues of \$266,084 produced an Operating Margin of 0.83%.

1 In Column (2), our accounting and pro forma adjustments are presented to normalize
2 BRUI's test year operations. A description of each adjustment is contained in Audit
3 Exhibit A-1.

4 Column (3) is the sum of Columns (1) and (2) and reflects the As Adjusted figures.
5 The accounting and pro forma adjustments resulted in Total Income (Loss) for
6 Return of \$31,279. Considering there was no customer growth during the test year
7 and using Total Income (Loss) for Return of \$31,279 and Total As Adjusted
8 Operating Revenues of \$284,413, an Operating Margin of 11.00% was computed.

9 Column (4) shows the effect of the proposed increase as computed by the
10 Water/Wastewater and Audit Departments. These adjustments are detailed in Audit
11 Exhibit A-1.

12 Column (5) shows per book operations as adjusted to normalize the test year and
13 revenues after the proposed increase is added to As Adjusted Revenues. In other
14 words, Column (5) represents per book operations including our proposed
15 adjustments and revenues for Phase I of BRUI's proposed rate increase. Using Total
16 Operating Revenues of \$358,672, Total Operating Expenses of \$277,420 and no
17 Customer Growth, I computed Net Operating Income and Total Income for Return of
18 \$81,252. Using the Total Income for Return of \$81,252, and Operating Revenues of
19 \$358,672, I computed an Operating Margin of 22.65% after the increase proposed by
20 BRUI.

21 **Q. PLEASE EXPLAIN THE ADJUSTMENTS IN AUDIT EXHIBIT A-1.**

22 **A.** The adjustments are as follows:

1 Adjustment # 1 – The Water/Wastewater Department proposes to adjust revenues
2 using a bill frequency analysis for the test year ended December 31, 2003. ORS's
3 witness Dawn Hipp provided me with the results of the bill frequency analysis, and
4 in her testimony, Ms. Hipp provides an explanation of the procedure used. The As
5 Adjusted Service Revenues computed by the Water/Wastewater Department Staff
6 totaled \$283,902. Subtracting the per book revenues of \$265,573 results in an
7 adjustment of \$18,329.

8 Adjustment # 2 – BRUI proposes to increase officers' salaries by \$8,613. ORS
9 determined that no salary increase was given, and therefore, ORS proposes no
10 adjustment.

11 Adjustment # 3 – BRUI proposes to increase other salaries by \$41. ORS determined
12 that no salary increase was given, and therefore, no adjustment is proposed.

13 Adjustment # 4 – BRUI proposes to increase expenses for repairs by \$545. Upon
14 examination, I determined that this adjustment was an estimate since there was no
15 known and measurable change or justification for the increase; therefore, ORS does
16 not allow the adjustment.

17 Adjustment # 5 – ORS proposes to reclassify bonuses of \$3,795 that were originally
18 booked to Taxes – Other. ORS does include these bonuses in Other Salaries. ORS
19 proposes to increase FICA/Medicare taxes by \$2,475 based on annualized wages.
20 These changes result in a reduction to Taxes Other Than Income of \$1,320 (\$2,475-
21 \$3,795). ORS determined that the proposed increase by BRUI of \$2,520 was an
22 estimate since no known and measurable changes were discovered which would

1 allow for an increase. I did not allow for BRUI's proposed adjustment to Taxes Other
2 Than Income.

3 Adjustment # 6 – BRUI proposes to include interest expense as an above the line
4 operating expense and to increase interest expense by \$27,339 for interest associated
5 with the new construction. However, BRUI provides no justification for this
6 proposal. I disallowed this adjustment since construction costs have not been
7 established and are therefore not known and measurable. I also propose to remove
8 interest expense of \$2,259. The booked interest included \$1,458 paid on equipment
9 notes that were satisfied following the test year and interest paid to BB&T of \$801 on
10 a personal line of credit. BRUI indicated it was unable to identify the use of these
11 funds since this had occurred many years ago.

12 Adjustment # 7 – Bush River proposes to increase depreciation expense for plant in
13 service by \$9,721. ORS proposes to reduce this amount by \$4,538. This adjustment
14 results from several factors and the calculation of the total is illustrated in Audit
15 Exhibit A-2. First, ORS proposes to adjust depreciation expenses using service life
16 periods recommended by the Water/Wastewater Department. Next, ORS proposes to
17 allocate certain plant purchased by Development Service, Inc. ("DSI") that is also
18 used by BRUI and Midlands Utility, Inc. ("MUI"). Finally, I reduced the computed
19 depreciation expense for the depreciation expense associated with tap fees. Tap fees
20 are contributions in aid of construction ("CIAC") and should be used to reduce rate
21 base, rather than be included in revenue. My adjustment removes depreciation
22 expense on plant paid for by CIAC.

1 The total depreciation expense as computed by ORS amounts to \$21,154 less the
2 Depreciation Expenses associated with cumulative tap fees of \$11,413, for ORS's
3 computed Net Depreciation Expense of \$9,741. I then subtracted the per book
4 depreciation expense of \$14,279 from ORS's computed Net Depreciation Expense
5 amount of \$9,741 for an adjustment of (\$4,538). See Audit Exhibit A-2 –
6 Computation of Depreciation Expense Adjustment.

7 Adjustment # 8 – BRUI proposes to decrease Chemical Expense by \$3,988. ORS
8 determined this adjustment was based on an estimate and did not allow this
9 adjustment. ORS proposes to adjust Chemical Expense by reclassifying \$12,268 of
10 purchases made during the year to Plant and Equipment. During the test year BRUI
11 purchased 1,000 feet of 6" pipe and 75 PVC Inserta tees. These items were
12 recorded as expenses in the chemical expense account on the books of the
13 company. (Please see Audit Exhibit A-2 for inclusion of these items as depreciable
14 assets).

15 Adjustment # 9 – ORS proposes to adjust vehicle expense by reclassifying auto and
16 truck insurance previously included in General and Administrative expenses. During
17 the test year, BRUI paid Harleyville Insurance Co., \$753 for vehicle insurance which
18 was charged to General and Administrative – Other operating expenses. ORS
19 proposes to reclassify this amount to Operating and Maintenance expenses – Vehicle
20 expense. Also, ORS proposes to allocate to MUI, its portion of insurance premiums
21 paid by BRUI. During the test year, BRUI made an insurance installment payment to
22 Auto-Owner Insurance Co. in the amount of \$5,106 of which \$3,926 was for related

1 vehicle insurance. Of the \$3,926 in vehicle premiums, \$808 was related to personal
2 vehicles. The remaining \$3,118 was related to vehicles and also included in General
3 and Administrative – Other operating expense. ORS proposes to allocate the \$3,118
4 to MUI and BRUI based on the percentage of single family equivalents. Single
5 family equivalents were 2,937 (69.09%) for MUI; 1,314 (30.91%) for BRUI.
6 Therefore, MUI would be charged 69.09% or \$2,154 and BRUI, 30.91% or \$964.
7 ORS proposes to make this allocation. BRUI proposes an adjustment of \$21, which
8 the ORS determined to be due to rounding and disallowed.

9 Adjustment # 10 – ORS proposes to increase Professional Services to reflect an
10 increase in accounting fees of \$650. ORS determined that BRUI's proposed increase
11 of \$1,600 is the result of an estimate and did not allow the adjustment.

12 Adjustment # 11 – BRUI proposes to increase Utilities expense by \$55. ORS
13 determined that BRUI's proposed increase of \$55 is the result of rounding and
14 proposes no change.

15 Adjustment # 12 – ORS verified the booked expenses related to Administration
16 expense. During the performance of the audit, ORS determined the Administration
17 expenses for both BRUI and MUI are paid by MUI. ORS compiled those expenses
18 that make up this category of expense from the books and records of MUI. Since
19 MUI has a fiscal year ending June 30th, ORS took a two year average of all expenses
20 in this category in an effort to estimate the appropriate allocation of Administration
21 expense on the books of BRUI. ORS's calculations indicate that the expenses to be
22 allocated totaled \$88,173. The average expenses were then allocated to each

1 company based upon single family equivalents, with MUI bearing 69.09% of the
2 expense and BRUI bearing 30.91% of the expense. ORS therefore recommends an
3 additional \$3,254 in Administration Expense be allocated to BRUI. BRUI proposes
4 to reduce these expenses by \$6,000.

5 Adjustment # 13 – BRUI proposes to amortize loan costs of \$81,591. Their proposal
6 is to amortize BRUI's proportionate share of these loan costs at the rate of \$1,500 per
7 year, over a 20 year period. ORS disallows this adjustment and proposes that all loan
8 costs be capitalized and no amortization be recognized. By capitalizing these costs,
9 BRUI, will recover the loan costs through depreciation expense over the useful life of
10 the asset to be constructed.

11 Adjustment # 14 – BRUI proposes to decrease Other Operating Expenses by \$1,794.
12 ORS determined that BRUI's proposed decrease of \$1,794 is the result of an estimate
13 and did not allow the adjustment.

14 Adjustment # 15 – Both ORS and BRUI propose to adjust for rate case expenses
15 associated with this filing. BRUI proposes to amortize an estimate of \$24,000 for rate
16 case expenses over a three-year period for an adjustment of \$8,000. ORS proposes to
17 amortize total rate case expenses of \$12,977 over a 5-year period for a total
18 adjustment of \$2,595. ORS's adjustment is comprised of \$700 for expenses for
19 accounting services incurred after the test year and \$12,277 for incurred legal
20 expenses, for a total rate case expense of \$12,977. ORS examined the time between
21 rate cases as one measure for an amortization period. BRUI's previous rate case
22 proceedings were in 1996 and 1987 resulting in approximately 8.5 years between rate

1 cases. However, ORS finds an 8.5 year amortization to be too long; therefore, ORS
2 proposes to use a more reasonable amortization period of 5 years for recovery of rate
3 case expenses.

4 Adjustment #16 – BRUI proposes to reduce Operating and Maintenance expense by
5 \$140 for a reduction in Sludge and Waste Disposal expense. ORS determined, during
6 the audit, that the per book amounts were accurately reflected and that the BRUI
7 reduction was an estimate; therefore, ORS disallows this adjustment.

8 Adjustment # 17 – ORS proposes to adjust truck expenses to reflect 1/3 of the
9 expenses to BRUI. BRUI stated that it used the Ford F-250 owned by DSI 1/3 of the
10 time. Total truck expenses as reflected on the books of DSI, amounts to \$1,109 which
11 is comprised of \$858 for vehicle insurance and \$251 for vehicle repairs. One-third
12 (1/3) of \$1,109 is \$370; therefore, to allow one-third (1/3) of the truck expenses,
13 ORS's adjustment is \$370 to Operating and Maintenance expense. ORS also
14 allocated and allowed one-third (1/3) of the total vehicle taxes to BRUI resulting in
15 an adjustment to Taxes Other Than Income of \$109. The total vehicle taxes as
16 booked by DSI were \$328 and therefore an adjustment of \$109 was required to
17 allocate one-third (1/3) of that expense to BRUI.

18 Adjustment # 18 – ORS proposes to allocate a portion of group insurance premiums
19 for general liability coverage and umbrella coverage on BRUI's Plant in Service. The
20 audit determined BRUI made an insurance installment payment of \$5,106, of which
21 \$3,926 was for insurance coverage on vehicles. The remaining amount of \$1,180
22 was allocated among the three affiliated companies based on the percentage of single

1 family equivalents. Single family equivalents were 2,937 (54.09%) for Midlands
2 Utility, Inc.; 1,314 (24.20%) for Bush River Utilities, Inc.; and 1,179 (21.71%) for
3 Development Service, Inc. Therefore, the amount allocated to MUI, is \$1,180
4 multiplied by 54.09% or \$639 and the amount allocated to DSI, is \$1,180 multiplied
5 by 21.71% or \$256, for a total allocation of \$895.

6 Adjustment #19 – BRUI proposes to increase Telephone expense by \$377. ORS did
7 not allow this adjustment as it was determined this was due to an estimate.

8 Adjustment #20 – BRUI proposes to include DHEC fines of \$3,500. This reflects a
9 reduction in DHEC fines of \$5,900 from the \$9,400 BRUI indicated it incurred
10 during the test year in its application. ORS determined this amount included fines of
11 \$7,138 and the Public Utility Assessment Tax of \$2,262. ORS proposes to eliminate
12 DHEC fines of \$7,138, as they are not considered a normal business expense, and to
13 reclassify the Public Utility Assessment Tax of (\$2,262) from DHEC fines to Taxes
14 Other Than Income. This is a total adjustment of (\$9,400). BRUI included both of
15 these items in the per book General and Administrative Expenses.

16 Adjustment #21 – ORS proposes to reflect the gross receipts taxes associated with
17 the as adjusted revenue. The gross receipts factor includes costs for administration,
18 the Public Service Commission and the Office of Regulatory Staff. The ORS
19 adjustment is computed using the As Adjusted revenue of \$284,413 multiplied by the
20 gross receipts factor of 0.007733226 resulting in an amount of \$2,199 less the per
21 book amount of \$2,262 for the adjustment of (\$63).

1 Adjustment # 22 – ORS proposes to adjust expenses for a 1.5% allowance for
2 uncollectibles associated with the as adjusted service revenues. The 1.5% allowance
3 is an industry standard and is less than BRUI’s actual test year uncollectible rate of
4 6.70%. ORS’s adjustment used the As Adjusted Service Revenues of \$283,902
5 multiplied by the 1.5% allowance factor, for a total adjustment of \$4,259.

6 Adjustment #23 – ORS proposes to adjust for income taxes associated with the As
7 Adjusted Revenue. See Audit Exhibit A-3 for the computation of income taxes.

8 Adjustment # 24 - Both ORS and BRUI propose to adjust service revenue for the
9 proposed increase. ORS’s proposed service revenue adjustment amounts to \$74,259
10 as provided by the Water/Wastewater Department. BRUI proposes to adjust the
11 service revenue amount by \$92,077.

12 Adjustment #25 – BRUI proposes to add to revenue an allowance of \$5,454 for
13 uncollectibles. BRUI’s adjustment of \$5,454, was computed using proposed revenues
14 of \$358,161. ORS proposes to adjust operating expenses for a 1.5% allowance for
15 uncollectibles. ORS’s adjustment is computed using the proposed increase of
16 \$74,259 multiplied by the 1.5% allowance, for an adjustment of \$1,114.

17 Adjustment #26 – ORS proposes to adjust gross receipts tax for the effect of the
18 proposed increase. The adjustment was calculated multiplying the proposed service
19 revenue increase of \$74,259 times the Gross Receipts Tax rate of .007733226 which
20 equals the adjustment of \$574.

21 Adjustment #27 – ORS and BRUI propose to adjust for income taxes associated with
22 the proposed increase. The BRUI proposed adjustment amounted to \$9,217. ORS’s

1 adjustment amounted to income taxes of \$22,598 which was based on revenue and
2 expenses after the proposed increase. See Audit Exhibit A-3 for the Computation of
3 Income Taxes.

4 **Q. PLEASE DESCRIBE THE REMAINING AUDIT EXHIBITS.**

5 A. Audit Exhibit A-2 shows the Depreciation Expense Adjustment. Audit Exhibit A-3
6 shows the Computation of Income Taxes. Audit Exhibit A-4 shows the Income
7 Statement for the Test Year Ended December 31, 2003. Audit Exhibit A-5 shows the
8 Balance Sheet for the Test Year Ended December 31, 2003.

9 **Q. DOES THE COMPANY MAINTAIN ITS BOOKS AND RECORDS IN**
10 **ACCORDANCE WITH PUBLIC SERVICE COMMISSION RULES AND**
11 **REGULATIONS?**

12 A. No. BRUI does not utilize the NARUC chart of accounts, and it does not completely
13 and accurately record inter-company transactions and allocations with its related
14 companies, DSI and MUI.

15 **Q. DOES ORS HAVE ANY RECOMMENDATIONS FOR THE COMPANY?**

16 A. Yes. ORS recommends that BRUI maintain its books and records for sewer
17 operations in accordance with the NARUC Uniform System of Accounts for Class B
18 Water and Sewer Utilities. In previous rate cases, the Commission ordered BRUI to
19 maintain its books and records in accordance with the NARUC Uniform System of
20 Accounts. See, Commission Order No. 96-44 (January 19, 1996), Docket No. 94-
21 727-S -- Application of Development Service, Inc. for Approval of an Increase in
22 Rates and Charges for Sewer Service and Docket No. 94-728-S -- Application of

1 Bush River Utilities, Inc. for Approval of an Increase in Rates and Charges for Sewer
2 Service, p. 17 and Commission Order No. 87-1094 (September 29, 1987), Docket
3 No. 86-423-S – Application of Development Service, Inc. for Adjustment of Rates
4 and Charges for Sewerage Service for Residential and Commercial Customers in Its
5 Service Area, 16. Furthermore, 26 S.C. Code Regs. 103-517 requires sewer utilities
6 to maintain their books and records in accordance with the NARUC System of
7 Accounts. To ORS’s knowledge, BRUI has neither sought nor received a waiver of
8 this requirement from the Commission. Yet, BRUI does not maintain its books and
9 records as required by previous Commission orders and the Commission’s
10 regulations.

11 ORS also strongly recommends that the affiliated companies of DSI, BRUI, and
12 MUI merge their operations and consolidate their books and records. These three
13 companies share common ownership, purpose, and staffing and inter-company
14 borrowings of assets, expenses and equipment. In addition, as revealed in the audit of
15 BRUI, allocations of expenses and assets are not being properly made by these
16 companies. If the companies were merged into one, allocations among the companies
17 would no longer be a problem. Furthermore, in BRUI’s previous rate case, DSI and
18 BRUI were “encouraged” by the Commission to explore the possibilities of merging
19 into one company. See, Commission Order No. 96-44 (January 19, 1996), Docket
20 No. 94-727-S -- Application of Development Service, Inc. for Approval of an
21 Increase in Rates and Charges for Sewer Service and Docket No. 94-728-S –

1 Application of Bush River Utilities, Inc. for Approval of an Increase in Rates and
2 Charges for Sewer Service, p. 17.

3 **Q. WHAT IS THE RESULTING OPERATING MARGIN COMPUTED BY ORS**
4 **IN THIS CASE?**

5 A. The ORS Staff computed an Operating Margin of 22.65%.

6 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

7 A. Yes, it does.

DIRECT EXHIBITS

OF

ROY BARNETTE

**DOCKET NO. 2004-259-S
BUSH RIVER UTILITIES, INC.
APPLICATION FOR RATE INCREASE
TEST YEAR ENDED DECEMBER 31, 2003**

REPORT OF THE AUDIT DEPARTMENT
THE OFFICE OF REGULATORY STAFF

DOCKET NO. 2004-259-S

BUSH RIVER UTILITIES, INC.

REPORT OF THE AUDIT DEPARTMENT

THE OFFICE OF REGULATORY STAFF

DOCKET NO. 2004-259-S

BUSH RIVER UTILITIES, INC.

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REPORT OF THE AUDIT DEPARTMENT

THE OFFICE OF REGULATORY STAFF

DOCKET NO. 2004-259-S

BUSH RIVER UTILITIES, INC.

SYNOPSIS

Amount Requested

Per Bush River Utilities, Inc.-----	\$92,077
Per ORS-----	\$74,259 *
Percentage Increase – Per ORS -----	26.16%

Operating Margin

Per Books-----	0.83%
As Adjusted-----	11.00%
After Proposed Increase-----	22.65%

*These figures were computed by the Water/Wastewater Department.

REPORT OF AUDIT DEPARTMENT
THE OFFICE OF REGULATORY STAFF
DOCKET NO. 2004-259-S
BUSH RIVER UTILITIES, INC.

ANALYSIS

ORS has made a review of the Application of Bush River Utilities, Inc., (hereinafter referred to as "BRUI") along with certain of BRUI's accounting records, relative to its application for authority to increase certain rates and charges as shown in Docket No. 2004-259-S.

The ORS respectfully submits the results of its review as follows:

1. BRUI filed an application on August 18, 2004 for approval of rates and charges for wastewater services provided to its commercial customers (including one wholesale utility customer) in Richland and Lexington Counties in South Carolina.
2. This matter is set for public hearing on Thursday, January 20, 2005 at 10:30 a.m.
3. BRUI's principal place of business is 816 East Main Street, Lexington, South Carolina 29072.
4. BRUI is a closely held corporation organized and existing under the laws of the State of South Carolina and is a public utility. BRUI's application utilizes a December 31, 2003 test period. BRUI has requested a new two-step schedule of charges for sewerage service provided to its residential and commercial customers.

The following is a summary of BRUI's most recent rates and charges and proceedings:

Date of Order	Effective Date	Docket Number	Amount Requested	Amount Granted	Operating Margin	
01/19/96	01/19/96	94-728-S	\$126,135	\$234,059*	8.22%	Approval of Rates
10/14/87	10/27/87	86-355-S	\$137,929	\$22,988	17.58%	Approval of Rates

*The Commission granted a combined increase for Development Service, Inc. and BRUI in Order No. 96-44, Dockets No. 94-727-S and 94-728-S.

The ORS's exhibits related to BRUI's proposed increase are as follows:

AUDIT EXHIBIT A: OPERATING EXPERIENCE AND OPERATING MARGIN

Shown in this exhibit is BRUI's sewer operations for the twelve months ended December 31, 2003, with respect to Operating Experience and Operating Margin. The exhibit's format is designed to reflect per book information and applicable accounting and pro forma adjustments necessary to correct or normalize the results of BRUI's test year operations.

ORS verified the per book balances to the books and records of BRUI. The book figures reflect that Operating Revenues for BRUI totaled \$266,084. Total Operating Expenses amounted to \$263,883 resulting in a Net Operating Income After Taxes of \$2,201. No Customer Growth is computed since the beginning and ending number of customers, for the test year, was the same. Using Total Income for Return of \$2,201 and Operating Revenues of \$266,084, ORS computed a per book Operating Margin of 0.83%. The net effect of the Accounting and Pro Forma Adjustments increased Total Income for Return from \$2,201 to \$31,279, which produces an Operating Margin of 11.00%.

BRUI has requested an increase in rates which would produce additional gross annual revenues of \$74,259 based on information supplied by the Water/Wastewater Department. ORS adjusted for uncollectible revenue, gross receipts taxes and income taxes associated with the proposed

increase.

After the proposed increase, Total Operating Revenues amounted to \$358,672 and Total Operating Expenses amounted to \$277,420, producing Net Operating Income for Return of \$81,252. ORS did not calculate Customer Growth since the beginning and ending customer count was 35 for the test year. Total Income for Return is \$81,252. Using Total Income for Return of \$81,252 and Operating Revenues of \$358,672, ORS computed an Operating Margin of 22.65% after the proposed increase.

AUDIT EXHIBIT A-1: EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS

Shown in this exhibit are the details of each accounting and pro forma adjustment necessary to correct or normalize BRUI sewer operations and to reflect the proposed increase. For comparative purposes, BRUI and ORS's adjustments are both presented in this exhibit.

AUDIT EXHIBIT A-2: DEPRECIATION EXPENSE ADJUSTMENT

Shown in this exhibit is ORS's computation of the Depreciation Expense adjustment. ORS annualized Depreciation Expense using rates supplied by the Water/Wastewater Department and allocated certain plant to BRUI affiliated companies, Development Service, Inc. and Midlands Utility, Inc. An adjustment was also made for Depreciation Expense associated with Contributions in Aid of Construction.

AUDIT EXHIBIT A-3: COMPUTATION OF INCOME TAXES

Shown in this exhibit are the computations of corporate state and federal income taxes. ORS used the state tax rate of 5% and federal tax rates of 15%, 25%, 34%, and 39% on the As Adjusted Income and the After the Proposed Increase Income.

AUDIT EXHIBIT A-4: INCOME STATEMENT FOR THE TEST YEAR ENDED DECEMBER 31, 2003

BRUI's Income Statement for the test year ending December 31, 2003 is reflected in this exhibit. ORS verified all balances contained in this statement to the books and records of BRUI.

AUDIT EXHIBIT A-5: BALANCE SHEET – AS OF DECEMBER 31, 2003

Shown in this exhibit is the Balance Sheet of BRUI as of the end of the test year. ORS verified the balances contained in this statement to the books and records of BRUI.

AUDIT EXHIBIT A

**BUSH RIVER UTILITIES, INC
OPERATING EXPERIENCE AND OPERATING MARGIN
TEST YEAR ENDED DECEMBER 31, 2003**

Description	(1) Per Books \$	(2) Accounting & Pro Forma Adjustments \$	(3) As Adjusted \$	(4) Effect of Proposed Increase \$	(5) After Proposed Increase \$
<u>Operating Revenues</u>					
Service Revenue	265,573	18,329 (A)	283,902	74,259 (H)	358,161
Other Revenue - Set Up Fees	50	0	50	0	50
Other Revenue - Late Fees	461	0	461	0	461
<u>Total Operating Revenues</u>	<u>266,084</u>	<u>18,329</u>	<u>284,413</u>	<u>74,259</u>	<u>358,672</u>
Operating & Maintenance Expenses	137,394	(10,181) (B)	127,213	0	127,213
General & Administrative Expenses	95,676	(421) (C)	95,255	1,114 (I)	96,369
Depreciation & Amortization Expense (1)	14,279	(4,538) (D)	9,741	0	9,741
Taxes Other Than Income	12,480	988 (E)	13,468	574 (J)	14,042
Income Taxes(2)	1,795	5,662 (F)	7,457	22,598 (K)	30,054
Interest Expense	2,259	(2,259) (G)	0	0	0
<u>Total Operating Expenses</u>	<u>263,883</u>	<u>(10,749)</u>	<u>253,134</u>	<u>24,286</u>	<u>277,420</u>
<u>Net Operating Income</u>	<u>2,201</u>	<u>29,078</u>	<u>31,279</u>	<u>49,973</u>	<u>81,252</u>
Customer Growth (3)	0	0	0	0	0
<u>Total Income For Return</u>	<u>2,201</u>	<u>29,078</u>	<u>31,279</u>	<u>49,973</u>	<u>81,252</u>
<u>Operating Margin (4)</u>	<u>0.83%</u>		<u>11.00%</u>		<u>22.65%</u>
<u>Interest Expense for Operating Margin</u>	<u>0</u>		<u>0</u>		<u>0</u>

Notes:

- (1) The computation of Depreciation Expense Adjustment is shown on Audit Exhibit A-2.
- (2) Computation of Income Taxes is shown on Audit Exhibit A-3.
- (3) Bush River Utilities, Inc. had no customer growth during the test period. The beginning and ending customer count was 35.
- (4) The Per Book Operating Margin included Interest Expense of \$2,259. The As Adjusted and After Proposed Increase Operating Margin does not include any allowable interest expense.

BUSH RIVER UTILITIES, INC.
EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

Adj. #	Revenue and Expenses Description	(A) Service Revenue	(B) O & M Expenses	(C) G & A Expenses	(D) Deprec. & Amort. Expenses	(E) Taxes Other Than Income	(F) Income Taxes	(G) Interest Expense
1	The ORS proposes to adjust revenues to reflect test year customer billings. (W/W)	\$	\$	\$	\$	\$	\$	\$
	Per ORS	18,329						
	Per BRUI	0						
2	BRUI proposes to increase the officers' salaries. ORS determined that no salary increase was given and therefore no adjustment was necessary. (A)							
	Per ORS			0				
	Per BRUI			8,613				
3	BRUI proposes to increase other salaries. ORS determined that no salary increases were given and therefore no adjustment was necessary. (A)							
	Per ORS							0
	Per BRUI							41
4	BRUI proposes to increase expenses associated with repairs. ORS determined that this adjustment was due to a BRUI estimate. (A)							
	Per ORS			0				
	Per BRUI			545				

BUSH RIVER UTILITIES, INC.
EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

Adj. #	Revenue and Expenses Description	(A) Service Revenue	(B) O & M Expenses	(C) G & A Expenses	(D) Deprec. & Amort. Expenses	(E) Taxes Other Than Income	(F) Income Taxes	(G) Interest Expense
		\$	\$	\$	\$	\$	\$	\$

5 ORS proposes to remove bonuses of \$3,795 that were originally booked to taxes-other. BRUI's adjustment of \$2,520 was based on an estimate. (A).

Per ORS
Per BRUI

3,795
0
(1,320)
2,520

6 BRUI proposes to include Interest Expense as an above-the-line operating expense. ORS does not consider Interest Expense as an operating expense, but includes Interest Expense, if applicable, when computing the Operating Margin. (A)

Per ORS
Per BRUI

(2,259)
27,339

7 ORS and BRUI propose to adjust depreciation expense for plant in service using ORS recommended depreciation rates. ORS also proposes to allocate certain plant in service to Development Service, Inc. and Midlands Utility, Inc. ORS reduced depreciation for expense associated with Contributions In Aid of Construction. (W/W & A)

Per ORS
Per BRUI

(4,538)
9,721

BUSH RIVER UTILITIES, INC.
EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

Adj. #	Revenue and Expenses Description	(A) Service Revenue	(B) O & M Expenses	(C) G & A Expenses	(D) Deprec. & Amort. Expenses	(E) Taxes Other Than Income	(F) Income Taxes	(G) Interest Expense
		\$	\$	\$	\$	\$	\$	\$

8 ORS proposes to adjust chemical expense by removing \$12,268 for pipe and Inserta tees. These expenses were put in plant in service and shown on Audit Exhibit A-2 - Depreciation Expense Adjustment. BRUI proposes to adjust this account based upon an estimate. (W/W & A)

Per ORS (12,268)
Per BRUI (3,988)

9 ORS proposes to adjust vehicle expense by reclassifying auto and truck insurance previously included in G&A expenses and to allocate to Midlands Utility, Inc., its portion of insurance premiums paid by BRUI. ORS determined that the BRUI adjustment was due to rounding. (A)

Per ORS 1,717 (4,679)
Per BRUI 0 21

10 ORS proposes to increase Professional Services to reflect an increase in accounting fees. ORS determined that the BRUI proposed increase to this expense is the result of an estimate. (A)

Per ORS 650
Per BRUI 1,600

BUSH RIVER UTILITIES, INC.
EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

Adj. #	Revenue and Expenses Description	(A) Service Revenue	(B) O & M Expenses	(C) G & A Expenses	(D) Deprec. & Amort. Expenses	(E) Taxes Other Than Income	(F) Income Taxes	(G) Interest Expense
		\$	\$	\$	\$	\$	\$	\$

11 BRUI proposes to increase Utilities expense. ORS proposes no change and determined that the BRUI proposed increase was due to rounding. (A)

Per ORS	0
Per BRUI	55

12 BRUI proposes to reduce Administrative expenses. ORS proposes to adjust Administrative expenses by \$3,254. The ORS adjustment is based upon BRUI's percentage of single family equivalents (30.91%) as compared to MUJ's percentage of (69.09%) times MUJ's total average Administrative expenses for the last two (2) fiscal years, 6-30-03 and 6-30-04. (A)

Per ORS	3,254
Per BRUI	(6,000)

13 BRUI proposes to amortize its proportionate share of loan costs at \$1500 per year for 20 years. ORS proposes to capitalize loan costs. (A)

Per ORS	0
Per BRUI	1,500

BUSH RIVER UTILITIES, INC.
EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

Adj. #	Revenue and Expenses Description	(A) Service Revenue	(B) O & M Expenses	(C) G & A Expenses	(D) Deprec. & Amort. Expenses	(E) Taxes Other Than Income	(F) Income Taxes	(G) Interest Expense
		\$	\$	\$	\$	\$	\$	\$

14 BRUI proposes to decrease Other Operating Expense. ORS determined that the BRUI adjustment was based upon an estimate. (A)

Per ORS
Per BRUI

0
(1,794)

15 ORS and BRUI propose to amortize rate case expenses. BRUI proposes to amortize an estimate of \$24,000 for expenses over 3 years. ORS proposes to amortize \$12,977 over a 5 year period. BRUI's last rate case was in 1994, however the ORS recommends a more reasonable time period of 5 years to recover these expenses. (A)

Per ORS
Per BRUI

2,595
8,000

16 BRUI proposes to reduce O & M expense for a reduction in Sludge & Waste Disposal expense. ORS determined that this reduction was an estimate. (A)

Per ORS
Per BRUI

0
(140)

BUSH RIVER UTILITIES, INC.
EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

Adj. #	Revenue and Expenses Description	(A) Service Revenue	(B) O & M Expenses	(C) G & A Expenses	(D) Deprec. & Amort. Expenses	(E) Taxes Other Than Income	(F) Income Taxes	(G) Interest Expense
		\$	\$	\$	\$	\$	\$	\$

17 ORS proposes to allocate truck expenses to reflect 1/3 of the expense for BRUI. These expenses were paid by DSI. (A)

Per ORS						109		
Per BRUI		370	0			0		

18 ORS proposes to allocate a portion of insurance costs to Midlands Utility, Inc. (\$639) and to DSI (\$256) for general liability and umbrella coverage on commercial property. This allocation was based on single family equivalents between the three affiliated companies. This premium was paid by BRUI. (A)

Per ORS	(895)
Per BRUI	0

19 BRUI proposes to increase telephone expenses. ORS determined that this adjustment was due to an estimate. (A)

Per ORS	0
Per BRUI	377

BUSH RIVER UTILITIES, INC.
EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

Adj. #	Revenue and Expenses Description	(A) Service Revenue	(B) O & M Expenses	(C) G & A Expenses	(D) Deprec. & Amort. Expenses	(E) Taxes Other Than Income Taxes	(F) Income Taxes	(G) Interest Expense
		\$	\$	\$	\$	\$	\$	\$
20	ORS proposes to reclassify the Public Utility Assessment Tax of \$2,262 to Taxes Other Than Income and remove DHEC fines of \$7,138. BRUI proposes an adjustment of (\$5,900) to reflect DHEC fines of \$3,500.(A)			(9,400) (5,900)		2,262 0		
	Per ORS							
	Per BRUI							
21	ORS proposes to reflect the gross receipts taxes associated with the as adjusted revenue. (A)					(63) 0		
	Per ORS							
	Per BRUI							
22	ORS proposes to adjust expenses for a 1.5% allowance for uncollectibles associated with the as adjusted revenues.(A)			4,259 0				
	Per ORS							
	Per BRUI							
23	ORS proposes to adjust income taxes associated with the As Adjusted Revenue. (A)						5,662 0	
	Per ORS							
	Per BRUI							
Total Accounting and Pro Forma Adjustments								
	Per ORS	18,329	(10,181)	(421)	(4,538)	988	5,662	(2,259)
	Per BRUI	0	(3,528)	6,458	9,721	2,520	0	27,339

BUSH RIVER UTILITIES, INC.
EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

Adj. #	Proposed Increase Description	(H) Operating Revenues \$	(I) Admin. & General \$	(J) Taxes Other Than Income \$	(K) Income Taxes \$
24	ORS and BRUI propose to adjust revenues for the proposed increase. (W/W)				
	Per ORS	74,259			
	Per BRUI	92,077			
25	BRUI proposes to add to the proposed increase an adjustment for 1.5% for uncollectibles. ORS proposes to adjust operating expenses for a 1.5% allowance for uncollectibles associated with the proposed increase. (A)				
	Per ORS	0	1,114		
	Per BRUI	5,454	0		
26	ORS proposes to adjust gross receipts tax for the effects of the proposed increase. (A)				
	Per ORS			574	
	Per BRUI			0	
27	ORS and BRUI propose to adjust income taxes associated with the proposed increase. (A)				
	Per ORS				22,598
	Per BRUI				9,217
Total Accounting & Pro Forma Adjustments					
	Per ORS	74,259	1,114	574	22,598
	Per BRUI	97,531	0	0	9,217

(A) - The Audit Department is primarily responsible for this adjustment.
(W/W) - The Water/Wastewater Department is primarily responsible for this adjustment.

BUSH RIVER UTILITIES, INC
DEPRECIATION EXPENSE ADJUSTMENT
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

FD = Fully Depreciated

* From the last Rush River Utilities, Inc. rate case, Docket No. 94-728-S

AUDIT EXHIBIT A-3

**BUSH RIVER UTILITIES, INC.
COMPUTATION OF INCOME TAXES
FOR THE TEST YEAR ENDED DECEMBER 31, 2003**

	As Adjusted Revenue	After Proposed Increase
	\$	\$
Operating Revenues	284,413	358,672
Less: Operating Expenses	245,677	247,365
Less: Interest Expenses	<u>0</u>	<u>0</u>
Taxable Income	38,736	111,307
State Tax Rate	<u>5%</u>	<u>5%</u>
State Taxes	1,937	5,565
Federal Taxable Income	36,799	105,741
1st \$50,000 @ 15%	5,520	7,500
Next \$25,000 @ 25%	0	6,250
Next \$25,000 at 34%	0	8,500
Remaining Balance at 39%	<u>0</u>	<u>2,239</u>
Federal Income Taxes	5,520	24,489
Total State & Federal Income Taxes	<u>7,457</u>	<u>30,054</u>
Less: Per Book and As Adjusted Income Taxes	<u>1,795</u>	<u>7,457</u>
Net Income Tax Adjustment	<u><u>5,662</u></u>	<u><u>22,598</u></u>

BUSH RIVER UTILITIES, INC.
INCOME STATEMENT
FOR THE TEST YEAR ENDED DECEMBER 31, 2003

	\$	\$	
<u>Revenue</u>			
Service Revenue		265,573	
Other Revenue - Set-up Fees		50	
Other Revenue - Late Fees		<u>461</u>	
<u>Total Operating Revenue</u>		266,084	
<u>Expenses</u>			Stat
Salaries - Officers	61,387		
Salaries - Other	45,959		
Repairs	9,455		
Taxes	12,480		
Interest	2,259		
Depreciation	14,279		
Chemicals	18,988		
Vehicle Expenses	1,479		
Professional Services	2,900		
Utilities	36,945		
Administration Expenses	24,000		
Other Operating Expenses	11,794		
Rate Case Expenses	0		
Sludge & Waste Disposal	9,140		
Telephone	1,623		
DHEC Fine	<u>9,400</u>		
Total Expenses		<u>262,088</u>	
Income Before Income Taxes		3,996	
Income Taxes		<u>1,795</u>	
Net Income		<u><u>2,201</u></u>	

AUDIT EXHIBIT A-5

**BUSH RIVER UTILITIES, INC.
BALANCE SHEET
FOR TEST YEAR ENDED DECEMBER 31, 2003**

ASSETS

Current Assets	\$	\$	\$
Cash			30,088
Fixed Assets			
Land		40,000	
Plant and Equipment	642,868		
Less: Accumulated Depreciation	<u>599,962</u>	<u>42,906</u>	82,906
Other Assets			
Due from Affiliates			<u>177,217</u>
Total Assets			<u><u>290,211</u></u>

LIABILITIES

Current Liabilities			
Payroll Taxes	2,420		
Notes Payable	<u>9,250</u>		11,670

EQUITY

Capital Stock	7,000		
Paid-in Capital	25,771		
Retained Earnings	<u>245,770</u>		<u>278,541</u>
Total Liabilities and Equity			<u><u>290,211</u></u>